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Memorandum for:

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The attached typescript was sent to Roger Robinson, NSC Staff per the request of David Wigg.

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Office of European Analysis
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DIRECTORATE OF INTELLIGENCE

Malta's Economic Situation

9 October 1984

Summary

The Maltese economy, lacking natural resources and a solid agricultural base, relies on trading and tourism and is crucially dependent on foreign investment and assistance. The recession in Western Europe -- which accounts for some two-thirds of Malta's trade -- has slowed economic growth from 11 percent annually in the 1970s to an estimated 1 percent in 1983. Traditional industries -- shipbuilding and repairing, tourism, textiles, and clothing -- have all been hard hit. [redacted] 25X1

Malta is now hoping to reorient its industrial base toward more sophisticated technology. Progress, however, will depend to a large extent on attracting foreign investment in relevant fields. Although the government is offering strong inducements to export-oriented foreign investors in an effort to stimulate employment, there are several disincentives that make massive investment unlikely:

-- Malta's infrastructure is poor: water shortages are chronic, electrical generation capacity is insufficient, and the telecommunications network is inadequate.

-- The government presence in industry is pervasive and tends to be both intrusive and heavy-handed.

This memorandum was prepared for Roger Robinson of the NSC Staff by [redacted] 25X1
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-- The political situation is volatile; tensions between the ruling Labor Party and the Nationalists, as well as between the government and the Church are likely to persist for some time. Prime Minister Mintoff is capricious, and his most likely successors do not seem any more likely to provide a stable and attractive environment for investors. 25X1

Prospects this year are for a modest recovery. It will be accompanied, however, by a continued rise in unemployment, which may further discourage investors since it will probably ensure that the government will continue to deny permission to lay off workers. 25X1

Economic Background

The 1970s marked an important turning point in Malta's economic history. After closing a NATO base which at its height employed 5 percent of the total labor force and contributed roughly 30 percent of GDP, Malta diversified into textile manufacturing and mass tourism. But as the Labor Party government increased benefits to its working class constituency, Malta slowly lost the labor cost advantage that had given it a competitive edge. It now hopes to restructure its industrial base toward high technology sectors to accommodate more highly skilled labor, but it lacks any specific long-range industrial plan. 25X1

With no significant natural resources and lacking a large local market, Malta is by nature a trading economy. Exports of goods and services totalled nearly $700 million in 1983 (equivalent to about 73 percent of GDP) while imports stood at about $850 million (some 90 percent of GDP). Because manufacturing is primarily geared to assembling products, imports are dominated by industrial supplies, capital goods, and fuel. Foreign exchange earnings come principally from textiles (which account for over half of merchandise exports), tourism, engineering products, and ship repair services.* Malta has shown a persistent structural deficit on the merchandise trade balance, but the current account has maintained a surplus based on the strength of tourism earnings, remittances from Maltese workers living abroad, and official grants. Investment inflows also have helped the overall balance of payments. 25X1

Government influence in Malta is pervasive. Public enterprises and parastatal companies have assumed an increasingly important role in recent years, particularly in banking, transportation, overseas trade, and communications. The public sector directly employs 24 percent of the total labor force and has a controlling interest in over 50 companies. Although some of this growth is the result of a concerted program of government intervention, much of it reflects ad hoc responses to specific crises and opportunities -- or retaliation against political opponents. 25X1

*Soviet trade data, which includes ship repairs, shows that ship repairs by the Maltese increased from about $100,000 in 1982 to $4,000,000 last year.

Impact of Recession

Partly because of the recent recession in Europe, Malta's economic growth in 1982-83 slowed significantly after the heady average annual pace of about 11 percent sustained during the 1970s. In 1982 real growth slowed to an estimated 2 percent, and last year it was down to about 1 percent as nominal GDP reached nearly $1 billion. All of Malta's economic mainstays -- ship repair, textiles, and tourism -- have suffered. The most dramatic consequence of Malta's 1983 recession was the surge in unemployment: the official figure* almost doubled during 1981-82 and increased a bit more in 1983. The socialist government responded by:

-- Seeking foreign assistance in the form of grants and loans.

-- Working in tandem with the General Workers Union to block ailing companies from shedding workers.

-- Expanding public sector employment (principally on public works projects).

-- Imposing profit limitations (10 percent for importers, 10 percent for wholesalers, 15 percent for manufacturers, and 20 percent for retailers).

-- Restricting import licenses and limiting business travel.

-- Making capricious tax assessments that favor political supporters. 25X1

In addition, the government has favored countries that agree to buy the equivalent in Maltese goods and penalized those with which the balance of trade is unfavorable. Over 65 categories of imports have been banned. Most notably, this past year Valletta has forbidden the import of Japanese and French goods because the government alleges that these two countries are not doing enough to redress their trade imbalances with Malta.** 25X1

Prices were frozen indefinitely in November 1982, and a "voluntary" wage cap was decreed on 1 January 1983. The price freeze is of indeterminate duration and has effectively leveled living cost increases for over a year and a half. The wage cap will remain in effect "as long as necessary." It has somewhat improved Malta's relatively uncompetitive labor rates. 25X1

*Official government statistics admit to a 9 percent unemployment rate, but the opposition Nationalists insist the real figure is closer to 14 percent and some party leaders put it substantially higher. 25X1

**Imports from Taiwan, Hong Kong, and Israel have been forbidden for some time, but political reasons were also a factor. 25X1

The Tourism Industry

The tourism sector traditionally depends heavily on lower- and middle-income tourists from the UK who tend to cancel travel plans in periods of general economic decline. Although the islands remain attractive to tourists, both Greece and Spain now offer equivalent facilities at lower prices. Morever, Malta lacks the diversity of facilities that encourage repeat visits. Tourism experienced a 16 percent decline last year. Even so, earnings totaled about $160 million in 1983, or some 16 percent of GDP, and the industry accounted for about 6 percent of total employment. 25X1

Maltese officials have high hopes for a newly refurbished gambling casino that opened last July under new Lebanese management. (The former British-based owners were forced to sell out and are currently appealing their case before the Maltese courts.) Mintoff cohorts are heavily involved in the new venture, which probably accounts for management's ability to fire 20 union workers in order to hire attractive hostesses. The success of this new venture depends not only on Lebanese marketing ability, but also on the attractiveness -- currently dubious, according to Embassy reports -- of neighboring hotels and restaurants. The Maltese themselves are prohibited from using the casino. 25X1

Symbolic of the problems faced by the tourist industry was the closing of the country's major hotel last year, which was accelerated when the Labor-controlled General Workers Union (GWU) would not allow the hotel to discharge 35 workers. Moves by private industry to lay off workers are routinely met by strike threats and charges that the owners are "unpatriotic." 25X1

Maltese Socialism -- and Pragmatism

The Labor Government has set up an extensive social welfare system, including free medical care and a generous pension system. The cost of these programs has been bearable thus far because of the relatively small number of retirees and because foreign aid* has paid for much of the Government's capital development program. Financing such an expensive social welfare system has become increasingly difficult, however, and has reduced the funds available for developing infrastructure to support tourism and industrial expansion. 25X1

Despite its leftist political ideology, the Maltese government is fiscally conservative -- budget deficits are rare and always small relative to GDP. When they occur, deficits are financed by concessional foreign grants

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and loans* -- usually linked to specific development projects -- or by drawing down accumulated cash surpluses. Monetary policy has traditionally been geared to supporting development goals rather than playing an active role in demand management. The Central Bank, three commercial banks, and five other financial institutions comprise the Maltese financial system. The government, mainly through equity ownership, has substantial influence over the operation of the system. [redacted] 25X1

Mintoff is currently considering creating offshore banking facilities in hopes of attracting foreign investors. Malta's proximity to the established financial centers in Switzerland, its lack of a legal framework, and the government's record of interference in the private sector, however, all militate against Malta becoming an important offshore banking center. [redacted] 25X1

Foreign Trade and Investment

Malta's foreign trade is oriented overwhelmingly toward the European Economic Community. In 1982 the EC supplied almost three-quarters of Malta's total imports, and bought a like percentage of its exports. Despite a continuous flow of ministerial and parliamentary visitors to Communist capitals, Malta's trade with the East remains small. In 1983 Malta sent 5.3 percent of its total exports to Eastern Europe, and 2.0 percent of its total imports came from the Bloc. Maltese officials claim that this represents an increase of over 25 percent in total trade with the East, but they clearly are disappointed with the results of Malta's overtures to the East. [redacted] 25X1

Last January, Mintoff visited Tripoli, ending the three years of cool relations that followed Libyan armed interference with Malta's oil-drilling operations. Libya has long been one of Malta's best export markets, and Libyan investment in joint ventures has been high (see Annex). From the Maltese point of view, the primary focus of relations with Libya is the development of economic, trade, and industrial relations. Mintoff has also played the Libyan card in the past to extract a better bargain when he negotiates renewal of the Italy-Malta aid agreement. He has balked, however, at Libyan requests that impinge on Maltese sovereignty. In 1980, for example, he refused Tripoli's demand for military bases even though it meant losing the oil provided by Libya at concessionary prices -- a subsidy worth some $35 million annually. [redacted] 25X1

Private foreign investment remains crucial to Malta's industrial development. Most of the export industry is foreign owned, and the largest private employer is a subsidiary of a US clothing manufacturer. There are currently about 150 foreign companies operating in Malta, most of them subsidiaries of West European firms, primarily West German (47 firms) and British (40 firms). [redacted] 25X1

*In 1983, Malta hoped to help finance the projected deficit of $46 million with $32 million in foreign loans and grants. Valletta expected a total of just over $14 million of these loans from Saudi Arabia and Abu Dhabi, mainly earmarked for the Marsaxlokk port project. The largest portion of grants was due to be provided under the Italian bilateral agreement, with EC grants making up the remainder. [redacted] 25X1

Recently Valletta has been encouraging investment in areas such as optical equipment, aviation, medical and surgical supplies, light engineering, exploration for oil on a joint basis, and marketing. Malta leases government-built factories at concessional rates and offers foreign investors the same tax incentives available to domestic investors -- including tax exemptions for imported capital equipment and tax reductions for reinvested profits. The adaptibility of the labor force, the low level of industrial unrest, and the duty-free access to the EC (except for certain textile and agricultural products) have been important factors in attracting foreign investors. 25X1

Disincentives to Foreign Investors

There are several important disincentives, however, the most obvious being Malta's weak infrastructure. The island's inadequate water supply and distribution system have already hampered the manufacturing and tourism sectors and visited considerable hardship on individual households. Recent contracts for two desalination plants should eliminate major shortages, although managerial inefficiency may limit their effectiveness. Electrical generation capacity is insufficient, and installation of additional generators is behind schedule. Malta's telecommunications network, moreover, is inadequate for an increasingly sophisticated economy. 25X1

The political situation presents an equally serious drawback. A prolonged dispute between Malta's two political parties is exacerbating the economic crunch. Polarization of Malta's class-conscious society is nothing new, but the rift has deepened since controversial parliamentary elections in 1981, when Mintoff kept Labor in power through gerrymandering. The opposition Nationalists have tried passive resistance, boycotts, and refusal to take their seats in Parliament to force Mintoff to accept "the will of the majority," but Mintoff remains in control. It seems likely that he will postpone elections -- due in 1986 -- if he is not confident of winning. 25X1

More recently, the opposition and government have locked horns over government attempts to seize control of all private education, including Catholic schools. The Education Act of April 1984 has pitted a large segment of the population -- including some Labor Party members whose children attend Catholic schools -- against government and Labor Party forces in increasingly violent confrontations. An attempt by Mintoff to appropriate some Church property has been declared unconstitutional by the courts (whose judges are still predominantly Nationalist-appointed). The ransacking of the Archbishop's curia and of the Valletta law courts by Labor Party bully boys last week is a clear sign of deep underlying tensions that will continue to shake investor confidence. 25X1

Another source of potential concern for investors is Dom Mintoff's authoritarian and capricious style of governing. The Labor government has for years had an adversarial relationship with the predominantly Nationalist business community. In addition to forbidding layoffs and generally taking the union's side in disputes with management in both local and foreign-owned firms, the government has resorted to petty harassment. In a recent dispute between the General Workers Union and a concrete company, for example, the government cut off telephone service to the factory and the managing director's house. 25X1

Leading businessmen responded to this hectoring by forming the Confederation of Private Enterprise (COPE), which has published a summary of private sector proposals for spurring Malta's economic recovery. Their ideas, not surprisingly, clash with most of the Labor government's tenets and have fallen on deaf ears. COPE's leaders, who head Malta's two largest companies, have been personally threatened by Mintoff. 25X1

Although we doubt that Mintoff will ever drop his basic antipathy to big business, the new laws on offshore banking and other service activities under consideration suggest that he is being forced by economic realities to soften his anti-capitalist posturing. It may be significant that the delegation picked to attend the Maltese-American Business Council meeting last May represented the best of Malta's business community -- rather than the usual collection of government hacks. 25X1

Outlook

The Maltese manufacturing sector will benefit somewhat from the moderate economic recovery in Malta's export markets this year. Export gains, however, will be limited by the relative strength of the Maltese lira, growing competition in textiles and clothing from LDCs, and protectionism among Malta's customers. Prospects, therefore, are for only a modest economic rebound this year and a continued rise in unemployment. 25X1

In the longer run, Malta's economic future will depend largely on the strength of economic growth in Western Europe and the extent to which it will translate into demand for Maltese exports. Given stable external conditions, Malta's economy should continue to expand, although the high growth rates of the 1970s are unlikely to be repeated. Malta's ability to attract new investments in higher-value-added industries will also be crucial. 25X1

For US investors, the most promising avenues appear to be Malta's newly-discovered interest in facilitating offshore banking and other service industries. The US Embassy in Valletta suggests that design and engineering firms could find it profitable to form joint ventures with local companies which have good contacts in the Middle East and Africa. In addition, US-flag shipping firms could use Malta's excellent port facilities for a transshipment point. If Mintoff really has decided that the plight of the Maltese economy will force him to bite the bullet and "deal with the devil" (multinational companies), he could bulldoze through legislation that would make Malta's services sector competitive with Greece, Cyprus, and the Persian Gulf States. In this case, Malta would become attractive to American companies that plan to deal with Africa and the Middle East. 25X1

The drawbacks and risks for foreign investors would still be considerable, however. In addition to infrastructure problems and political volatility, potential investors would have to bear in mind Malta's remarkably poor track record in its dealings with foreign companies. Firms already established in Malta complain about difficulties in obtaining import permits and foreign exchange, complications with local tax authorities, and whimsical

changes in government regulations. Moreover, Mintoff -- who usually reviews and approves each new commercial deal personally -- favors a number of tactical ploys that frequently drive potential investors away. One of his favorite gambits is to wait until a firm is ready to sign the contract and then spring unacceptable demands on them. We do not believe that Mintoff is about to relinquish power (even if he does move up to the Presidency or over to the ministry of trade as rumored), and in any case his most likely successors do not seem any more likely to provide a stable and attractive environment for investors. [redacted] 25X1

Malta's Vital Statistics:

The Republic of Malta consists of 3 islands -- Malta, Gozo, and tiny Comino, covering a total of about 122 square miles. Its capital is Valletta.

Position: Malta is located 60 miles south of Sicily, 180 miles from the North African mainland.

Climate: Temperate. Mild winters, warm, dry summers. Average yearly temperature of 65 degrees. Average rainfall 22 inches a year, but almost no rainfall between May and September.

Population: About 315,000.

Physical features: No mountains or rivers, but a series of low hills with terraced fields on the slopes characterize the island. A well-indented coastline provides numerous harbors, bays, creeks, sandy beaches and coves.

Religion: Predominantly Roman Catholic.

Language: Though they have their own language, English is spoken fluently by the majority of the Maltese.

Government: Malta's Constitution provides for a parliamentary democracy.

Political Parties: The 2 dominant parties are the Labor Party now in power and the Nationalist Party currently in opposition.

Libyan Investment in Malta

There are no figures available on total private foreign investment in Malta. The US Embassy estimates that the UK has probably been the largest source of foreign investment in money terms, followed by the US, Libya, and West Germany. The book value of Libyan investment is estimated at about $50 million, compared to $65 million for US firms. Libya participates in at least 21 companies. The most significant involvement is through the Libyan Arab Foreign Investment Company (LAFICO), which has controlling interest in two Libyan-Maltese investment companies -- the Libyan Arab Maltese Holding Company (LAHMCO) and the Libyan Maltese Investment Company (LMIC). LAHMCO, the larger of the two holding companies, has a stake in 9 companies, most of which have received investment funds from France, the UK, Brazil, and Italy. These companies export a significant proportion of their output to Libya. 25X1

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Table 1. Maltese Foreign Trade

Thousand $

	Exports*		Imports	
	1979	1983	1979	1983
Total	424,290	363,340	753,670	732,540
OECD	338,730	284,380	686,990	674,540
Of Which:				
France	13,310	7,870	39,432	25,082
FRG	143,520	116,750	107,540	117,130
Italy	17,980	36,050	167,440	196,130
United Kingdom	84,600	61,520	161,850	123,370
United States	8,480	11,570	47,390	83,790
USSR	60	5,840	2,470	1,640
Eastern Europe	12,710	13,390	12,020	13,260
Romania	0	0	1,790	300
Poland	7,870	4,030	3,790	4,680
East Germany	570	1,170	560	520
Hungary	40	770	1,410	1,280
Czechoslovaki	3,950	5,690	4,440	3,610
Bulgaria	280	1,730	30	2,870
Albania	NA	0**	NA	2,265
Cuba	0	0	50	40
PRC	110	10	5,590	3,420
Yugoslavia	210	260	320	11,800
Libya	33,170	11,990	540	250
North Korea	0	0	20	680

* Includes re-exports.

**1982 data.

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Table 2. Why Negotiations With Malta Can Be Difficult: Some Recent Examples

US --	In 1983, when Bluebell, Wrangler's local subsidiary in Malta, wanted to lay off up to 330 workers because of declining profits, the Maltese government refused permission. So far, Bluebell has settled for shedding workers by attrition and instituting a 4-day work week. At some point, however, Bluebell may have to choose between defying the government and closing down the Malta operation.	25X1
Norway --	In June 1983 Norwegian honorary consuls and business leaders met with Foreign Minister Sceberras Trigona. They were "astounded" by his implication that Norway somehow "owed" something to Malta, and that it was Norway's responsibility to promote Maltese exports to Norway and to encourage Norwegian investment in Malta.	25X1
Austria --	Tripoli-based Austrian Ambassador Matsch, interested in establishing a consular presence in Malta, was "rudely shooed out" of the Foreign Minister's office last March. His request for an exequatur was dismissed with the words, "You have to do something about buying more Maltese goods and changing your lop-sided trade balance before we can consider exequaturs and the like."	25X1 25X1
France --	In March 1983, the French commercial counselor in Valletta remarked that Maltese officials cannot understand why the French government is not able to direct its parastatal corporations to come to Malta; he complained of the difficulties he had in satisfying the Maltese government, which wants instant gratification from its political/economic discussions.	25X1
USSR --	After a 5-day visit in Malta to discuss building a new surgical instrument factory in July 1984, the Soviet delegation left without reaching any agreement. Negotiations were broken off in part because of problems concerning price and quality of goods, but the final straw came when the Maltese government refused to give bank guarantees for payment of Soviet equipment to be installed in the factory.	25X1

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Italy -- Following a meeting with Maltese officials in May 1984 to negotiate a new financial protocol, the Italian Ambassador commented: They wanted every last penny from the old protocol, with no strings attached, before they would begin discussing a new protocol -- "as if they were doing us a favor by negotiating a new protocol." The Deputy Director of Political Affairs in the Italian Foreign Ministry told Ambassador Rentschler earlier this month that he "lamented the naivete of the Maltese in believing that the Italian government could simply order one or another firm to open shop on Malta." 25X1

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Table 3. COPE's Solutions for Economic Troubles

-- Unbridle private enterprise from the effects of 700 government price orders, licensing controls, and frequent policy changes. In short, let the profit motive play a positive role in the economy. -- Have the government invest more of its resources in the economy. While the government has been husbanding its resources (as evidenced by the large foreign exchange surpluses), the slack in investment has been taken up by the private sector. Private investment, which in 1976 represented 43 percent of total investment, now accounts for 73 percent of total investment.

-- Privatize the banks in order to streamline this sector. Also allow foreign banks to come and create an off-shore banking center.

-- Eliminate "ex-officio" tax assessments.

-- Create foreign investment incentives. The previous nationalist government offered a 10-year tax holiday for foreign investors. The current government ended this practice and current incentives are minimal.

-- Education. Upgrade trade schools. In the longterm, integrate science and technology training with Malta's industrial development.

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